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## FISCAL IMPACT REPORT

SPONSOR SFC DATE TYPED 2/17/04 HB \_\_\_\_\_

SHORT TITLE Research and Development Gross Receipts SB 31/SFCS

ANALYST Taylor

### REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY04	FY05			
	(4,200.0)	Similar	Recurring	General Fund
	(380.0)	Similar	Recurring	Municipalities
	(20.)	Similar	Recurring	Small Counties/Cities Assistance

(Parenthesis ( ) Indicate Revenue Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Response Received From

Taxation and Revenue Department (by telephone)

### SUMMARY

#### Synopsis of Bill

The Senate Finance Committee substitute for Senate Bill 31 enacts a tax credit for qualified research and development small businesses. The credit is equal to the sum of all the businesses' gross receipts taxes, compensating taxes and withholding taxes due to the state in the reporting period. The deductions may only be claimed for a total of 36 months. Businesses that claim this credit would be ineligible to claim in the same reporting period the capital equipment tax credit, the investment credit or the technology jobs tax credit. The bill requires the Taxation and Revenue Department to administer the credit pursuant to the Tax Administration Act.

Qualified research and development small businesses are defined to include corporations, general partnerships, limited partnerships, limited liability companies, sole proprietorships and similar entities that: employed less than 25 persons, had revenues that did not exceed \$10 million in any prior fiscal year, were not owned by another business as of the prior month, made qualifying research and development expenditures in the previous 12 month period that are equal to at least 20 percent of total revenues.

Qualified research expenditures are defined as expenditures directly related to qualified research. The definition excludes research funded by another person or governmental entity, and expenditures for property owned by a municipality or county in connection with an industrial revenue bond or for which the tax payer has received any credit from the capital equipment tax Credit Act, the Investment Credit Act or the Technology Jobs Tax Credit Act.

Qualified research is defined as research that is technological in nature and intended to be useful in the development of a new or improved business component of the taxpayer. Qualified research must be related to new or improved function, performance, reliability or quality, but not style, taste, cosmetic or seasonal design factors.

Effective date: July 1, 2004

### **FISCAL IMPLICATIONS**

TRD reports that their records and industry information indicate that about 280 payers currently in New Mexico might qualify for the proposed deduction. These businesses generated \$30 in taxable gross receipts in FY03. In addition, these companies have estimated tangible personal property of about \$2 million that would be eligible for the compensating tax deduction.

Applying the average effective state gross receipts tax rate of 3.75 percent by these values yields a revenue loss of \$1.2 million from gross receipts taxes in FY05. Applying the compensating tax rate of 5 percent against the \$2 million base implies a revenue loss of \$100 thousand. TRD reports that withholding taxes revenue from these businesses was \$3 million in 2003. Thus, the total estimated general fund revenue loss from the proposed taxes would be about \$4.3 million.

The bill also reduces local government revenues, although it specifies that the credit is against state taxes. This is because the entire 5 percent state gross receipts tax is a state tax. The 1.25 percent that is sent to the municipalities is a form of revenue sharing. Multiplying \$30 million by 1.25 percent implies a local government revenue loss of \$380 thousand. Similarly, there is a \$20 thousand reduction in money available to the small cities, small counties assistance program.

### **ADMINISTRATIVE IMPLICATIONS**

The TRD analysis reports the following administrative impact:

The provisions in this bill would have an administrative impact on the department. The department must revise forms and instructions for claiming the deduction, and systems must be modified in order to accept and track the deduction.

The definition of “qualified research” is the same definition used in the current Technology Jobs Tax Credit Act. This definition is very broad and somewhat vague. Particular problem areas include the phrase “new or improved business component”. It is not at all clear what this means, and has caused difficulties when evaluating applications for the technology jobs tax credit. The phrase “process of experimentation” has been difficult to interpret as well. Some interpretational issues can be addressed by regulation.